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April 18, 2003

The Honorable Mitch Landrieu  
Chairman  
Louisiana Juvenile Justice Commission  
PO Box 44371  
Baton Rouge, Louisiana 70804

Re: Final Report – Tallulah Juvenile Facility

Dear Representative Landrieu:

We have completed our review and analysis of certain documents provided by the State of Louisiana Department of Public Safety and Corrections (the “Department”) and the State of Louisiana Division of Administration (the “Division of Administration”) related to the juvenile prison in Tallulah, Louisiana.

Facts

In 1994, the Department entered into a Cooperative Endeavor Agreement (the “Agreement”) dated February 10, 1994, as amended (Louisiana Cooperative Endeavor Agreement number 403-4058-A and approved by the Division of Administration February 24, 1994) with the Town of Tallulah (the “Town”) to provide for the construction of a new facility (the “Tallulah Facility”) to house juvenile offenders in Madison Parish, and the Town entered into a management services agreement dated February 10, 1994 with Trans-American Development Associates (“TADA”), a single purpose entity owned by James B. Brown, George A. Fischer and Verdi Adam, to manage the construction and operation of the Tallulah Facility. In March 1995, the Agreement was assigned by the Town to TADA for which the Town receives an annual fee of \$150,000. In September 1999, the Department took over operational control of the Tallulah Facility.

A more detailed history of the Agreement and related matters is set forth in a report from the Office of Legislative Auditor to the Honorable Donald “Don” Cravins, Chairman, Senate Judiciary B, and Members of the Committee dated May 16, 2001 (the “Senate Report”), a copy of which is attached hereto as Exhibit A.

A list of the documents reviewed is attached hereto as Exhibit B. Capitalized terms used herein and not otherwise defined have the meanings set forth in the document list.

Summary of Questions Presented and Conclusions

**What are the rights and obligations of the State and the Department under the Agreement?**

The Department has an obligation under the Agreement to maintain a minimum number of adjudicated juveniles at the Tallulah Facility at a minimum per diem rate. The Agreement is terminable due to non-appropriation (after which the Department would have no further obligations under the Agreement) or due to breach (after which the Department would have to continue to pay debt service, property taxes and insurance on the Tallulah Facility). The Department would have no obligation under the Agreement if the Agreement was determined to be invalid as a cooperative endeavor agreement, as a debt of the State or as a non-state provider contract. In connection with the issuance of the 1998 Bonds, the Deputy Attorney General of the Department issued an opinion that the Agreement was valid and enforceable against the Department, and therefore the Department may be precluded from any contrary position.

**What are the rights and obligations of the State and the Department under the Bond Documents?**

The 1998 Bonds are not obligations of the State or the Department by law or contract. However, the Department and the Deputy Attorney General of the Department did participate in the offering of the 1998 Bonds and will be bound by the representations and opinions given. Standard & Poor's has therefore taken the position that the 1998 Bonds are equivalent to appropriation-backed bonds of the State and that any failure to appropriate under the Agreement could result in a downgrade of the State's credit rating.

**Whether a potential purchase of the Tallulah Facility by the State or the Department is warranted by its obligations under the Agreement or the 1998 Bonds?**

From our inquiries, we understand that the State is negotiating to purchase the Tallulah Facility in part to mitigate the costs of the Agreement and to protect its credit rating. However, the State and the Department may want to consider certain actions prior to entering into the purchase which could effectively eliminate or reduce the costs of the Agreement while protecting the State's credit rating.

## Conclusions

The rights and obligations of the State and the Department under the Agreement and the 1998 Bonds are directly related to the validity of the Agreement and the impact on non-appropriation on the State's credit rating. Assuming the validity of the Agreement based on the opinions and representations of the Department given in connection with the 1998 Bonds, we recommend that the State clarify with Standard & Poor's and the other rating agencies their positions on the effect of non-appropriation on the State's credit rating under the circumstances described below and determine the estimated costs of continued appropriation, non-appropriation and purchase of the Tallulah Facility. The State can then compare, on a present value basis, the costs associated with the options outlined below when determining whether or not to continue to appropriate for, operate or purchase the Tallulah Facility. We expect that implementation of the Cure Option (as set forth in the section entitled Conclusions below) by the State would be the least expensive of the options presented that are likely to be available to the State.

## Analysis

### **What are the rights and obligations of the State and the Department under the Agreement?**

#### *Payment obligations of the Department.*

Under the Agreement, the Department agrees to maintain at all times during the term of the Agreement a minimum population at a per diem rate per person. The per diem amount is reduced in the event that the Department assumes operational duties of the Tallulah Facility. Current payment obligations under the Agreement are approximately \$4.2 million (based on a minimum population of 686 and an assumed per diem rate of \$16.83 per day, which rate was the rate in effect in December 1999 and may have increased thereafter). The Department is also required to pay property taxes and insurance related to the Tallulah Facility.

#### *Rights of termination and related rights of the Department.*

##### **1. Termination for Non-Appropriation**

The Agreement states that the Department's obligation to provide the minimum number of adjudicated juveniles is subject to appropriation and provides for termination of the Agreement as of the last day of the fiscal year for which sufficient funds were appropriated if the State of Louisiana fails to appropriate sufficient moneys for the Department to pay its obligations under the Agreement. The Department is obligated to use its best efforts to obtain adequate appropriations to fund the Agreement. Therefore, although the Department is obligated to use best efforts to obtain an adequate appropriation of funds, the Department would have no further obligations under the Agreement should the State fail to appropriate sufficient funds.

2. Termination for Breach

The original Agreement permitted the Department to terminate the Agreement with no further payment obligations if the Town failed to maintain the facilities in accordance with certain standards set forth in the Agreement. However, Amendment No. 8 to the Agreement executed in 1997 prior to the issuance of the 1998 Bonds removed this termination right. Because the Department has taken operational control of the Tallulah Facility, the Department may terminate the Agreement only if the Department continues to pay the reduced per diem rate so long as it operates the Tallulah Facility. The reduced per diem rate is intended to closely approximate the amount required to pay debt service on the indebtedness used to finance or refinance the Tallulah Facility, as well as property taxes and insurance on the Tallulah Facility (which parallels comparable language from Amendment No. 6 to the Agreement). Therefore, subject to the obligations of the Department to seek adequate appropriations as described above, the Department may terminate the Agreement so long as it continues to pay the reduced per diem amount.

3. Termination due to Invalidity

The obligations described above assume that the Agreement is a valid and enforceable obligation of the Department. Certain arguments exist to challenge the validity of the Agreement, as described below. However, we note that in connection with the issuance of the 1998 Bonds, the Department's Deputy General Counsel issued an opinion that the Agreement is a valid and enforceable obligation of the Department and the Department may be precluded from taking a contrary position. *We do not offer any opinion or analysis with respect to the validity or enforceability of the Agreement or the likelihood that the Agreement will be found invalid.*

a. *Not a Valid Cooperative Endeavor Agreement*

The Senate Report sets forth the requirements recognized by the Attorney General for validity of cooperative endeavor agreements.

1. The expenditure or transfer of public funds or property must be based on a legal obligation or duty. We assume that, because the Department utilizes the Tallulah Facility to satisfy part of its mission, this prong would be satisfied.

2. The expenditure must be for a public purpose. We assume that, because the Department is a public agency established to address a public purpose, this prong would be satisfied.

3. The expenditure must create a public benefit proportionate to its cost. There is evidence presented that this requirement may not be satisfied.

First, from the Senate Report, the minimum number of juvenile offenders to be housed at the Tallulah Facility under the Agreement of 686 exceeds the legal operational capacity of 440, resulting in the Department paying per diem amounts for 246 juvenile offenders that are not

housed at the Tallulah Facility. The Department's Response indicates that the payments are not for offenders who are not housed at the Tallulah Facility, but for buildings that were originally designed to house more offenders and that are now utilized for other related purposes. Therefore, the amounts paid under the Agreement for 686 inmates may not be proportionate to the public benefits of housing only 440 inmates at the Tallulah Facility.

Second, as discussed above, the payments under the Agreement at a minimum amortize the indebtedness used to finance the Tallulah Facility, like a capital expenditure. However, the Agreement does not provide that the Department will own the Tallulah Facility at the end of the term. Therefore, the structure of payments may not be proportionate to the public benefits of obtaining the right to use the Tallulah Facility on an operating basis only.

Third, from the documents provided, we understand that TADA and FBA are single purpose entities formed to perform under the Agreement, with no assets other than the Tallulah Facility and the revenue stream under the Agreement. However, TADA has been able to distribute to its three owners dividends and salaries of over \$8.7 million from 1996 through 2001, including \$2 million of dividends distributed the day following the issuance of the 1998 Bonds. Note that the P&N Letter, which was the result of an engagement of P&N by the Department to provide recommendations and assurances regarding proposed rental payments under the Agreement, indicated that the proposed annual profit by TADA/FBA "may be excessive given the lack of equity risk the owners of FBA are subject to." Therefore, the costs of the Agreement may not be proportionate to the public benefit received if the single purpose beneficiary of the revenue stream under the Agreement was able to distribute \$8.7 million over five years to its stockholders.

Fourth, from the documents provided, we understand that the costs of constructing the Tallulah Facility were approximately \$22 million and that the aggregate principal amount of the 1998 Bonds was approximately \$33 million. Based on the amortization schedule in the Placement Memorandum, approximately \$29,765,000 of the 1998 Bonds are still outstanding. Although the Department is currently responsible for the operation of the Tallulah Facility and the costs related thereto, the Department is still required to make payments under the Agreement to cover the debt service on the 1998 Bonds. The Department will still not own the Tallulah Facility after payment of these amounts under the Agreement. To the extent that the State could finance and construct a new facility at less cost, the payments made under the Agreement may not be proportionate to the public benefit received.

Finally, many of the amendments to the Agreement increased the minimum number of juvenile offenders required to be incarcerated at the Tallulah Facility or the per diem rate per juvenile, resulting in a continued increase in fees paid under the Agreement. In the Department's response, the Department stated that certain of these amendments were intended to enable the 1998 Bonds to achieve an investment grade rating from Standard & Poor's. As described below, the 1998 Bonds are not direct obligations of the State or the Department. Therefore, the increases in the fixed sum paid by the Department under the Agreement may not be proportionate to the public benefit received by obtaining an investment grade rating on the 1998 Bonds.

*b. Not a Valid Debt*

The Department has made and is currently making minimum payments under the Agreement that are structured to produce sufficient revenue to pay principal and interest due on the 1998 Bonds, much like a capital lease. In the Department's Response, the Department states that these minimums were established in an amount that was, as represented by bond counsel, equivalent to the debt service and other requirements on the indebtedness used to refinance the Tallulah Facility. However, at the end of the payment term under the Agreement, the Department will not own the Tallulah Facility, as one might expect from a capital payment structure. Rather, the Tallulah Facility will remain the property of FBA. In the Department's Response, the Department states that the Agreement was structured in this way to be considered an operating lease rather than a capital lease to avoid constitutional and general obligation debt limits.

To determine whether the Agreement constitutes indebtedness to which constitutional and statutory limitations apply, we have reviewed Attorney General Opinion No. 94-452 dated September 15, 1994, which interpreted the types of transactions that should be considered indebtedness for purposes of the State's debt limits.

The Opinion evaluated State debt limitations in connection with "net state tax supported debt" which includes debt secured by capital leases of immovable property payable by annual appropriation of the State. To the extent that the Agreement constitutes debt secured by a capital lease, the Agreement may constitute net state tax supported debt to which constitutional and statutory limitations apply.

The Opinion set forth a Maryland judicial decision that classifies a capital lease as a lease that pays out more than 90% of the cost of the leased item. As described above, the Agreement pays out more than 100% of the cost of the Tallulah Facility, even after the Department has taken control of the Tallulah Facility. Under accounting standards of FASB 13, a lease is characterized as a capital lease if (a) the present value at the beginning of the lease term of the minimum lease payments equals or exceeds 90% of the fair value of the leased property to the lessor, (b) collectibility of the minimum lease payments is reasonably predictable and (c) no important uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease. The Agreement arguable satisfies these requirements as well.

The Opinion discussed whether bonds issued by a conduit issuer which are secured by a cooperative endeavor, per diem or other obligation of the State (except for a lease) which is subject to annual appropriation by the State legislature would be considered debt, a structure comparable to the 1998 Bonds. With respect to cooperative endeavor obligations, the Opinion stated that the determination must be made on a case by case basis because the term "cooperative endeavor" is very broad and vague. With respect to per diem obligations, the Opinion stated that, although a true per diem obligation would not in itself be considered to be indebtedness, a per diem obligation disguised as a capital lease could be considered to be indebtedness. Therefore, assuming that the Agreement is a capital lease as described above, the obligations of

the Department under the Agreement may constitute indebtedness to which constitutional and statutory limitations would apply.

*c. Not a Valid Term*

The Department has consented to the assignment of the Agreement to TADA, FBA and the bond trustee, and therefore the current obligation of the Department is to make payments to the bond trustee. Title 15, Chapter 7, Section 1087 of the Louisiana Statutes provides that, notwithstanding any other law to the contrary, contracts with non-state providers for services to juvenile offenders assigned to the Department shall not exceed a term of five years without renewal and renegotiation. Although the Agreement was originally entered into with the Town, the assignment of the Agreement by the Town to TADA may have converted the Agreement into a contract with non-state providers.

In connection with the issuance of the 1998 Bonds, the Department's Deputy General Counsel issued an opinion that the Agreement is not subject to this limitation. At the same time, the Placement Memorandum includes a risk factor related to this interpretation, stating that any action to determine the applicability of this statute would likely be one of first impression for the courts. Given these facts, it is uncertain whether a court would determine that Section 1087 would apply to the Agreement or the impact of such determination.

**What are the obligations of the State and the Department  
under the Bond Documents?**

*The Department and the State are not directly liable for the 1998 Bonds.*

Based on our review of the bond documents we received, the 1998 Bonds are beneficial interest certificates evidencing a proportionate right to receive certain payments made by the Department under the Agreement. Neither the State nor the Department is directly obligated to pay the 1998 Bonds, which are payable solely from payments by the Department under the Agreement, subject to appropriation as described above. The Placement Memorandum includes numerous references to the limited sources of payment for the 1998 Bonds and expressly states that the obligation of the Department under the Agreement does not constitute a liability of or a lien or charge upon the moneys or property of the Department or the State, except for moneys appropriated by the legislature therefor.

*Effect on the State's Credit Rating.*

Through our inquiries, we understand that Standard & Poor's intends to consider lowering the State of Louisiana's credit rating if the State fails to make full appropriations to fund the Agreement. After conversations with Alex Frazier of Standard & Poor's, we understand that, because of the significant involvement of the Department in the issuance of the 1998 Bonds, the Standard & Poor's position is based on a belief that the 1998 Bonds represent obligations of the Department and the State similar to appropriation backed bonds issued by the State.

The 1998 Bonds are also secured by a mortgage, assignment or leases and rents and security agreement on the Tallulah Facility.

In connection with the bond issue, the Department delivered (1) a consent to the assignment of the Agreement to the bond trustee, (2) a closing certificate which makes representations about the assignment and the Agreement and (3) an opinion of Deputy General Counsel which opines as to the enforceability of the Agreement and the assignments. In addition, the Placement Memorandum includes significant disclosure about the State and the Department. Therefore, Standard & Poor's does not differentiate bonds issued by the State from the 1998 Bonds which were not issued by the State.

The Division of Administration included in its materials a fax from Barry Friedman of Friedman, Luzzatto & Co. (the placement agent for the 1998 Bonds) from May 10, 2002, which included a commentary from Standard & Poor's dated June 13, 2001. The commentary indicates that Standard & Poor's will give appropriation-backed bonds a higher credit rating (more closely aligned with the issuer's general obligation credit rating) and will consider rating action with respect to any non-appropriation for these obligations.

We have not made inquiries of other State officials regarding the relationship with Standard & Poor's and do not know the extent to which representatives of the State have discussed this issue with management at Standard & Poor's to try to differentiate the Agreement from a true appropriation-backed arrangement. We do not know what the impact of non-appropriation would be on the State's credit rating given by other rating agencies like Moody's Investors Service or Fitch. In that regard, attached as Exhibit C hereto is a draft letter to the President of Standard & Poor's from Bernard E. Boudreaux, Jr. of the Department (which letter was included in materials provided by the Division of Administration) (the "Draft Letter") arguing that Standard & Poor's should not permit the non-appropriation for the Agreement to have an adverse impact on the State's credit rating. No execution copy of this letter was included in the materials we received from the Division of Administration, and no copy of this letter was included in the information sent from the Department in response to our prior request letters.

Mr. Frazier acknowledged in our conversation that Standard & Poor's likely would not consider a downgrade in the State's credit rating due to non-appropriation if the Agreement was held invalid, as the State would not be able to fund an invalid arrangement by law not by choice, or if the State cured the default under the 1998 Bonds caused by such non-appropriation.

**Whether a potential purchase of the Tallulah Facility by the  
State or the Department is warranted by its obligations under  
the Agreement or the 1998 Bonds?**

Through our inquiries, we understand that State is interested in purchasing the Tallulah Facility in part to mitigate the continued obligations under the Agreement and to protect its credit rating from Standard & Poor's. A downgrade in the State's credit rating could have a significant negative impact on the interest rate paid by the State on its general obligation bonds in excess of any financial benefit gained from non-appropriation under the Agreement.

The 1998 Bonds are secured by a mortgage on the Tallulah Facility in favor of the bond trustee. Because the Tallulah Facility is encumbered by this lien, the purchase of the Tallulah Facility by the State or the Department would result in a double payment by the State or the Department for the Tallulah Facility, once to pay off the 1998 Bonds and once to purchase the property from FBA.

We recommend that the State pursue the options described below which may protect the State's credit rating at a lower effective cost before proceeding with the purchase of the Tallulah Facility.

Conclusions

The rights and obligations of the State and the Department under the Agreement and the 1998 Bonds are directly related to the validity of the Agreement and the impact on non-appropriation on the State's credit rating. Assuming the validity of the Agreement due to the opinions and representations of the Department given in connection with the 1998 Bonds, we recommend that the State take the following actions:

*Determine the current position of Standard & Poor's and the other rating agencies on non-appropriation.* The State should contact Standard & Poor's and the other rating agencies to discuss their current position on the effect of non-appropriation for the 1998 Bonds on the State's credit rating. The State should attempt to differentiate the Tallulah Facility and the 1998 Bonds from the other cooperative endeavor agreements of the State as outlined in the Draft Letter and this letter. To the extent that Standard & Poor's changes its position or the other rating agencies and the marketplace take a contrary position to Standard & Poor's, the State would not need to purchase the Tallulah Facility or take any further action to protect its credit rating.

*Determine the position of Standard & Poor's and the other rating agencies on non-appropriation coupled with a cure of any payment default on the 1998 Bonds.*

Mr. Frazier indicated that Standard & Poor's likely would not downgrade the State's credit rating if any default in payment to the bondholders is cured by the State (the "Cure Option" as described below).

To the extent that the State determined not to appropriate funds for the Agreement and the non-appropriation resulted in a payment default under the 1998 Bonds, the State could consider curing the default as it relates to the bondholders by agreeing to pay the bondholders any shortfall after exercise of all remedies under the bond documents. As discussed above, the 1998 Bonds are secured by a mortgage on the Tallulah Facility and there are reserves on deposit under the trust indenture to offset amounts due under the 1998 Bonds. The bondholders (or Ambac as the bond insurer) could pursue all remedies available under the bond documents to maximize the value of the collateral securing the 1998 Bonds and then the State could agree to pay any amounts that remain outstanding to make the bondholders whole.

A secondary option would be to cure the default by offering to purchase from each bondholder the 1998 Bonds at par after any payment default caused by non-appropriation. Then, as the holder of the 1998 Bonds on which a payment default has occurred, the State could direct the bond trustee to foreclose on the mortgage on the Tallulah Facility securing the 1998 Bonds. The proceeds of the sale would be returned to the State as payments on the 1998 Bonds, together with amounts on deposit under the trust indenture for payment of the 1998 Bonds. The purchase out of foreclosure would effectively transfer ownership of the Tallulah Facility free and clear from the lien of the 1998 Bonds such that the purchaser of the Tallulah Facility would not have to pay off the 1998 Bonds and also pay FBA for the Tallulah Facility.

In either case, the State might be able to finance the shortfall or purchase payments with its general obligation bonds at a lower interest rate than is currently paid on the 1998 Bonds. These options should also be acceptable to Ambac as the bond insurer for the 1998 Bonds and would preserve any relationship the State expects to have with Ambac in the future.

*Determine the estimated costs of continued appropriation.* The State should determine the total cost to the State of (a) continuing to appropriate for the 1998 Bonds and continuing to operate the Tallulah Facility and (b) continuing to appropriate for the 1998 Bonds but ceasing to operate the Tallulah Facility.

*Determine the estimated costs of non-appropriation.* Because the Agreement may be terminated due to non-appropriation, the State should determine the true impact of non-appropriation on the State's credit rating in the marketplace and the relative financial impact on the State. The State may want to consult with its financial advisors and underwriters to gauge this impact, which would be a function of the expected increase in

interest rates for the State's general obligation bonds, the length of time in which the downgrade would be expected to be in effect and the principal amount of general obligation bonds the State expects to issue during that time.

*Determine the estimated costs of the Cure Option.* To the extent that Standard & Poor's and the other rating agencies agree that there would be no downgrade in the State's credit rating if the Cure Option were implemented, the State should determine the cost of the Cure Option. As part of this calculation, the State should offset amounts to be paid by the State by amounts on deposit under the trust indenture as reserves for payment of the 1998 Bonds and by the property value of the Tallulah Facility. The State should also take into account any ability to leverage these payment obligations with low interest general obligation bonds of the State.

*Determine the estimated cost of purchasing the Tallulah Facility.* The State should determine the estimated cost of purchasing the Tallulah Facility, which would include the prepayment of the 1998 Bonds.

The State can then compare, on a present value basis, the costs associated with the options outlined above to determine whether or not to continue to appropriate for, operate or purchase the Tallulah Facility. Based on our review of the documents and assuming Standard & Poor's does not change its prior determination to downgrade the State's credit rating due to non-appropriation of the Agreement, we expect that implementation of the Cure Option by the State would be the least expensive of the options presented, including options to continue appropriations or to purchase of the Tallulah Facility.

We recognize that there are additional factors to consider with respect to the Tallulah Facility and the 1998 Bonds, such as the impact on the State's juvenile justice system and potential alternative uses of the Tallulah Facility by the State. We have not attempted to address these factors in this letter as they are best considered by State government officials.

We are available to discuss this letter at your convenience. This letter is furnished for your benefit and may not be relied on or utilized in any manner or for any purpose by any other person without our prior written consent.

Sincerely,

PIPER RUDNICK LLP

A handwritten signature in black ink, appearing to read "Richard J. Marks". The signature is fluid and cursive, with a prominent "R" and "M".

Richard J. Marks  
Partner

EXHIBIT A

Senate Report

(See Attached)

EXHIBIT B

Documents Reviewed

1. The Agreement and the nine amendments thereto
2. The Senate Report, including the response of the Department dated May 15, 2001 (the "Department's Response") (attached)
3. Consent and Acknowledgment dated as of May 29, 1998 among the Department, the Town and TADA
4. The Management Services Agreement between TADA and FBA, L.L.C. (a wholly-owned subsidiary of TADA) ("FBA")
5. Certain correspondence dated August 4, 2000 from TADA and FBA to the Department referencing the Agreement
6. A draft letter of Postlethwaite & Netterville ("P&N") to the Department dated December 2, 1999 (the "P&N Letter")
7. "Estimating the Costs and Economic Impacts of the Louisiana Juvenile Correction Facilities: Madison and LaSalle Parishes" issued by Robert J. Newman and M. Dek Terrell, Division of Economic Development & Forecasting, Department of Economics, E.J. Ourso College of Business, Louisiana State University.
8. Correspondence from Chase Manhattan Trust Company to FBA dated November 22, 2000
9. Assignment dated as of March 30, 1995 between the Town and TADA pursuant to which the Town assigned its rights, title and interest in the Agreement to TADA
10. Assignment dated as of May 29, 1998 between TADA and FBA pursuant to which the TADA assigned its rights, title and interest in the Agreement to FBA.
11. Absolute Assignment dated as of May 29, 1998 between FBA and the bond trustee pursuant to which the FBA assigned its rights, title and interest in the Agreement to the bond trustee
12. The Private Placement Memorandum dated May 29, 1998 (the "Placement Memorandum"), related to \$32,995,000 Privately-Placed Taxable Revenue Beneficial Interest Certificates (Tallulah Correctional Center for Youth Project, a 700-Bed Facility) (the "1998 Bonds") evidencing proportionate interests in payments to be made by the Department pursuant to the Agreement
13. Draft letter to President, Standard & Poor's from Bernard E. Boudreaux, Jr. of the Department (attached)
14. Certain correspondence related to the Tallulah Facility in the possession of the Division of Administration
15. Attorney General Opinion No. 94-452 dated September 15, 1994
16. Title 15, Chapter 7, Part X, Section 1087 of the laws of the State of Louisiana
17. A consent by the Department to the assignment of the Agreement to the bond trustee for the 1998 Bonds
18. A closing certificate of the Department related to the assignment
19. An opinion of Deputy General Counsel related to the Agreement and issued in connection with the 1998 Bonds.

EXHIBIT C

Draft Letter

(See Attached)



DANIEL G. KYLE, PH.D., CPA, CFE  
LEGISLATIVE AUDITOR

OFFICE OF  
**LEGISLATIVE AUDITOR**  
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May 16, 2001

**THE HONORABLE DONALD R. "DON" CRAVINS,**  
**CHAIRMAN, SENATE JUDICIARY B, AND**  
**MEMBERS OF THE COMMITTEE**  
Baton Rouge, Louisiana

Dear Senator Cravins:

The Senate Judiciary B Committee expressed concerns regarding the operation of the Tallulah Correctional Center for Youth. In order to address those concerns, the Legislative Auditor sought answers to two questions:

1. What was the actual construction cost and the amount of debt service of the Tallulah Correctional Center for Youth?
2. What amount did the owners of the Tallulah Correctional Center for Youth receive from inception of the agreements with DOC?

This report is intended to respond to these questions and report additional matters for consideration resulting from our examination.

**TALLULAH CORRECTIONAL CENTER FOR YOUTH**

**DOC - CITY OF TALLULAH - TRANS-AMERICAN**

The Louisiana Department of Public Safety and Corrections, Corrections Services (DOC) entered into a Cooperative Endeavor Agreement with the City of Tallulah (City) during February 1994 to construct a juvenile correctional facility. At the same time, the City entered into a Management Services Agreement with Trans-American Development Associates (Trans-American) to operate the facility. Subsequently, during March 1995, the City assigned its rights and obligations to Trans-American.

**THE HONORABLE DONALD R. "DON" CRAVINS,  
CHAIRMAN, SENATE JUDICIARY B, AND  
MEMBERS OF THE COMMITTEE**

May 16, 2001

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**TRANS-AMERICAN - FORMATION AND OWNERSHIP**

Trans-American Development Associates was created solely to build and subsequently operate the Tallulah Correctional Center for Youth (TCCY). The owners of Trans-American are Mr. George A. Fischer of Metairie, Louisiana; Mr. James R. Brown of Tallulah, Louisiana; and Mr. Verdi Adam of Baton Rouge, Louisiana. Trans-American was responsible for the operations of the facility. The same principals later created FBA, a limited liability corporation, to hold ownership of the facility, and Frostline, Inc., to provide phone services to the juvenile offenders.

Mr. Adam explained that Trans-American was advised by its attorneys to create FBA as a "bankruptcy remote company" which would hold ownership of the facility's buildings and land while Trans-American continued operating TCCY. This separation of ownership from operations was intended to protect the facility's assets in the event of bankruptcy.

**WHAT WAS THE ACTUAL CONSTRUCTION COST OF TCCY?**

TCCY was constructed in two phases. The facility's minimum security structures were erected as phase I in 1994, while the phase II structures erected from 1995 through 1997 relating mostly to high security lockdown facilities. Trans-American records indicate construction costs of \$6,286,254 and \$16,151,864 for phase I and phase II, respectively, for a total construction cost of the facility of \$22,438,118.

**WHAT AMOUNT OF DEBT WAS INCURRED  
BY THE OWNERS OF TCCY?**

Trans-American financed the cost of original construction through bank loans, capital leases, and internal financing. On January 27, 1997, Trans-American refinanced \$16,893,318 of its outstanding loans, capital leases, and internal financing with the issuance of \$29,475,000 in bonds. Included in the proceeds of the bond issue was \$4,687,270 for future construction. The remaining \$7,894,412 of bond proceeds were used to fund a reserve of \$2,947,500 and pay fees associated with the bond issue of \$4,946,912. During May 1998, Trans-American again refinanced its outstanding debt through a second bond issue for \$32,995,000.

**WHAT AMOUNT WAS PAID TO THE OWNERS OF TCCY?**

The financial records of Trans-American and its TCCY related companies are maintained in the offices of Gulf Engineers and Consultants (GEC), a Baton Rouge firm owned by Mr. Fischer and Mr. Adam. During our examination of these records, we noted dividend distributions made by Trans-American and its related companies from August 1996 through April 2001. Those

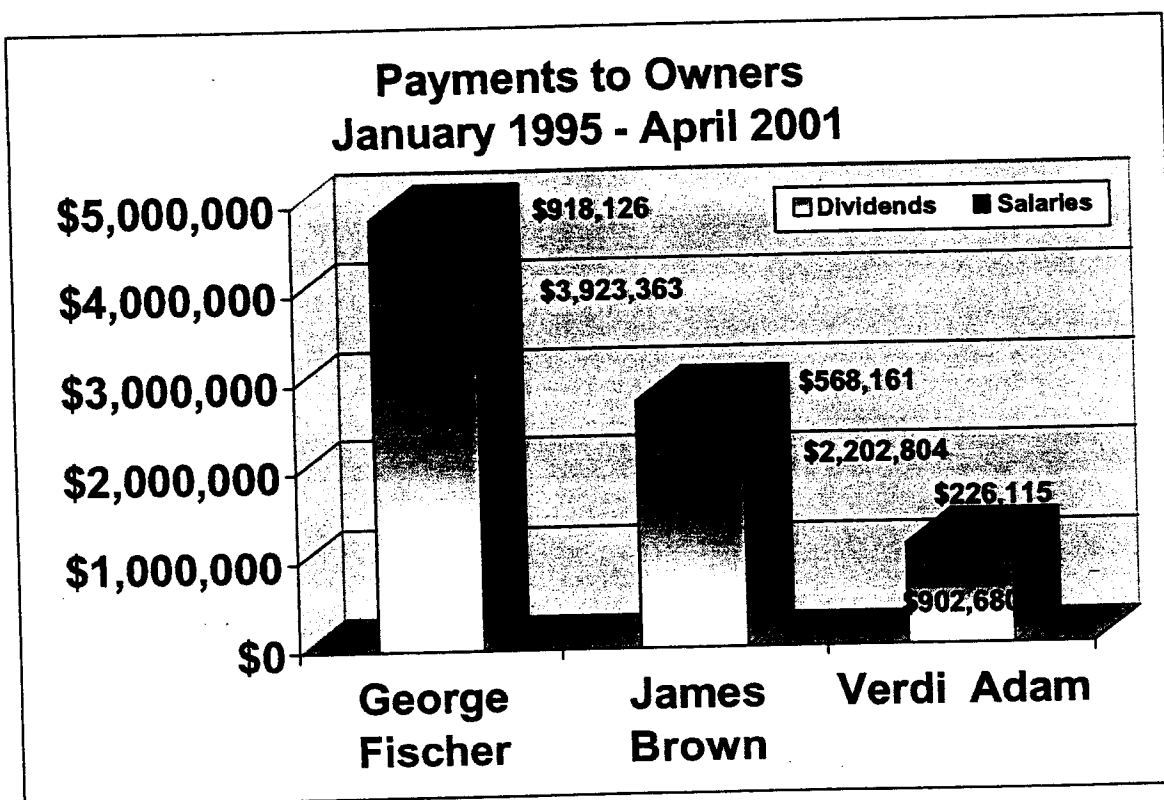
**THE HONORABLE DONALD R. "DON" CRAVINS,  
CHAIRMAN, SENATE JUDICIARY B, AND  
MEMBERS OF THE COMMITTEE**

May 16, 2001

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payments to Mr. Fischer, Mr. Brown, and Mr. Adam totaled \$3,923,363; \$2,202,804; and \$902,680, respectively.

We further noted that Trans-American paid salaries to the owners from January 1995 through December 1998. Those payments to Mr. Fischer, Mr. Brown, and Mr. Adam were \$918,126; \$568,161; and \$226,115, respectively. No salaries were paid after December 1998.



Therefore, the combined dividends and salaries paid to the owners from January 1995 through April 2001 was \$8,741,249.

During our discussions with DOC Secretary Richard Stalder, we pointed out the amount of money distributed to the owners. Secretary Stalder's immediate response was that these types of payments bring to mind the question, "What is unjust enrichment?" Secretary Stalder explained that in his opinion, the facility probably failed because the owners pulled out too much money. He added that this is a risk inherent with private operators of correctional facilities.

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**MATTERS FOR FURTHER CONSIDERATION**

Our examination of TCCY revealed the following concerns regarding the construction of the facility, the agreements between DOC and the City and its operations:

1. Trans-American was selected even though the company had no prior experience constructing or operating correctional facilities. According to both Secretary Stalder and Mr. Adam, Trans-American's original intent was to subcontract the facility's operations to an experienced contractor.
2. We could find no current or former public official who would take responsibility for selecting Trans-American.
3. The original agreement provided for DOC to pay the City a specified rate per day, per offender housed in the facility. Thereafter, numerous amendments were made to the agreements between the parties, which were primarily in favor of Trans-American. The amendment approved on January 27, 1997, guarantees Trans-American payment for more offenders than are actually housed in the facility. On the same day, Trans-American refinanced its debt obtaining over \$7.6 million in additional funds. On the subsequent day, Trans-American paid its three owners \$2 million in dividends.
4. The amendment dated January 8, 1997, specifies that DOC may not cancel the agreement so long as the indebtedness related to TCCY remains outstanding. Therefore, at the end of the term of the agreement, even though DOC will have paid for all of the costs of financing, construction, and operation of TCCY, the facility will remain the property of FBA.
5. The DOC agreement may not meet all of the requirements of a cooperative endeavor as defined by Louisiana law and the Attorney General.

**SELECTION OF TRANS-AMERICAN**

The facility began through an agreement between the City and DOC. Simultaneously, the City entered into an agreement with Trans-American to fulfill its obligations to DOC. Trans-American did not have previous experience constructing or operating a juvenile detention facility. Furthermore, we could find no public official, current or former, who would take responsibility for selecting Trans-American.

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**Former Governor Edwards** explained that he was not involved in the selection of Trans-American. However, he explained that he had Secretary Stalder meet with Mr. Fischer and Mr. Brown. He further stated that he left any decision to approve the arrangement up to Secretary Stalder's discretion and that he (Edwards) did not instruct Secretary Stalder on this matter. Mr. Edwards also said that he considered Mr. Fischer and Mr. Brown to be his friends and conceded that Mr. Fischer probably spoke with him about the arrangement.

**Secretary Stalder** told us that he did not select Trans-American because this was a decision made by the former Mayor of Tallulah, Donald Walker.

**Mr. Walker** told us that it was Mr. Brown who approached him. According to Mr. Walker, he and Mr. Brown then met with Secretary Stalder about the idea, and Mr. Brown negotiated directly with Secretary Stalder. Mr. Walker added that, in his opinion, there was never any doubt that Mr. Brown's group would get the contract.

**Mr. Brown** explained that when Mayor Walker asked him for a way to help Tallulah, he (Brown) came up with the idea of building a juvenile facility. According to Mr. Brown, he and Mayor Walker then took the proposition to Secretary Stalder.

**Mr. Fischer** stated that he worked at getting the contract for the facility for Trans-American. To accomplish this, he explained that he had telephone conversations and meetings with DOC officials. He added that he did not have discussions or meetings with officials of the City, because the City was not originally involved in the matter. Mr. Fischer, who served as Governor Edwards' campaign manager in 1991, further stated that he discussed the arrangement with Governor Edwards because if the governor had objected, the prison would not have been built.

**NUMEROUS AMENDMENTS MADE TO DOC AGREEMENT**

During February 1994, TCCY began through an agreement between DOC and the City. The City then, through a separate agreement, assigned its rights and obligations to Trans-American. Thereafter, numerous amendments have been made to the agreements between the parties, which were primarily in favor of Trans-American. The amendment entered into on January 27, 1997, guarantees Trans-American payment for more offenders than are actually housed in the facility. On the same day, Trans-American refinanced its debt obtaining over \$7.6 million in additional funds. On the subsequent day, Trans-American paid its three owners \$2 million in dividends.

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**DOC and the City entered into a Cooperative Endeavor Agreement dated February 24, 1994.** The term of the agreement was the sooner of 25 years or at the time of repayment of the debt associated with construction. DOC agreed to pay the City \$48 per day per offender housed in phase I, and \$58 per day per offender when phase II is completed and operational. Payments were subject to legislative appropriation. In the event the City failed to fulfill its obligations, DOC had the option of taking control of the facility's operations. In the event of such a takeover, DOC could terminate the agreement, so long as DOC paid the City enough to pay the principal, interest, and other requirements of the initial debt incurred.

The City was responsible for constructing or causing to construct the facility. Phase I was established to have a minimum capacity of 365 beds, while phase II minimum capacity was to be 155. The City agreed to operate and maintain the facility while DOC agreed to house a minimum of 350 juveniles in phase I and 150 juveniles in phase II.

**The City and Trans-American entered into a Management Services Agreement dated February 10, 1994.** Under the terms of this agreement, the City retained the services of Trans-American to operate the facility in the manner set forth in the Cooperative Endeavor Agreement.

**Amendment I** of the DOC-City Agreement was dated August 30, 1994. This amendment increased the minimum capacity of phase II from 155 to 305 beds. In addition, commencement of phase II was changed from 36 months after completion of phase I to immediately upon completion of phase I. Furthermore, DOC agreed to maintain a population of not less than 300 juveniles in phase II, which is an increase from the original obligation of 150.

**Amendment II** of the DOC-City Agreement was dated November 30, 1994, and signed by Secretary Stalder for DOC. This amendment increased the per diem from \$48 to \$50 per juvenile during phase I, and from \$58 to \$60 upon the completion of phase II subject to legislative appropriation.

**Amendment III** of the DOC-City Agreement was dated February 10, 1995, and signed by Secretary Stalder for DOC. This amendment increased the minimum capacity of phase I from 365 to 409 beds. The minimum number of juveniles to be housed by DOC increased from 350 to 386 offenders.

**The City assigned its rights and obligations** under the DOC-City Agreement to Trans-American on March 30, 1995. Trans-American agreed to pay the City \$150,000 annually as consideration for the assignment.

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**Amendment IV** of the DOC-City Agreement was dated April 21, 1995, and was signed by Secretary Stalder for DOC. This amendment incorporated the previous three amendments into a revised agreement. DOC's obligation to provide the minimum number of juvenile offenders in phase II was changed from 180 days after commencement of phase II to when phase II is fully completed and operational. Commencement of phase I changed from when the facility is completed and becomes operational to when any portion of phase I is completed and occupied.

**Amendment V** of the DOC-City Agreement was dated July 12, 1995, and was signed by Secretary Stalder for DOC. The per diem is increased from \$50.00 to \$52.88 per juvenile offender during phase I, and from \$60.00 to \$62.88 per offender upon the completion of any portion of phase II. According to records obtained from DOC, this adjustment was made to fund educational programs at the facility.

**Amendment VI** of the DOC-City Agreement was dated December 20, 1996, and was signed by Secretary Stalder for DOC. "Initial Debt" is redefined to include any debt incurred to refinance the aforementioned debt.

**Amendment VII** of the DOC-City Agreement was dated January 8, 1997, and was signed by Secretary Stalder for DOC. This amendment deletes the provision allowing DOC to terminate the Agreement and abandon use of the facility under certain conditions, by notifying the City in writing.

**Amendment VIII** of the DOC-City Agreement was dated January 22, 1997, and contained a Division of Administration approval stamp dated January 27, 1997, and was signed by Mr. Trey Boudreaux, an Undersecretary to Secretary Stalder. This amendment changed DOC's financial obligation in the event it took over operation of the facility. The previous obligation was a rate based on the principal and interest owed for constructing the facility, plus property taxes and insurance. The new provision provided that as of January 1997, DOC would pay a \$16.62 per diem on a minimum of 686 juvenile offenders, regardless of the number actually housed in the facility. This amendment amounted to a guarantee to the owners assuring them of at least \$11,196 per day. Furthermore, Trans-American's profit margin increased whenever less than 686 offenders were housed. Records indicate that 686 offenders were not housed on any day at TCCY. This per diem was to be adjusted every 12 months based on increases in the Consumer Price Index. DOC took over operations of TCCY on September 25, 1999.

**Amendment IX** was dated October 30, 1997, and signed by Mr. Boudreaux. A 12-man litter crew was established, and DOC agreed to pay the contractor \$3,912 per month to cover the cost of security officers to supervise the work.

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On August 4, 2000, an agreement signed by Secretary Stalder converted the appropriated amount of \$4,283,295 into 12 monthly payments of \$356,941.25 each.

**AGREEMENT GUARANTEES PAYMENT FOR 686  
OFFENDERS THOUGH COURT RESTRICTED  
ACTUAL POPULATION TO MUCH LESS**

As stated previously, during January 1997, DOC agreed in Amendment VIII that, in the event DOC took over operation of the facility, DOC would pay Trans-American \$16.62 per day on a minimum of 686 offenders. According to correspondence received from DOC, at the time this agreement was entered, TCCY was authorized by the United States Court to house only 540 offenders. Between January 1997 and October 1998, the court increased this amount to 620 only to later reduce the operational capacity to 536. This operational capacity was later further reduced by the court and currently stands at 440 offenders.

DOC took over the operations of TCCY on September 25, 1999, and began paying Trans-American in accordance with its agreement. Therefore, DOC currently pays Trans-American \$17.10 (the \$16.62 adjusted for the increase in the Consumer Price Index and agreement dated August 4, 2000) for 686 offenders when it is authorized to house only 440 offenders. This results in DOC paying Trans-American \$1,535,409<sup>1</sup> per year for offenders not actually housed at TCCY. This \$1,535,409 represents 36% of the total \$4,283,295 appropriated for such payments.

**DIVIDENDS TO OWNERS COINCIDE WITH REFINANCING**

The largest individual dividend payments were made on January 28, 1997, one day after approval of Amendment VIII noted previously, and the corresponding refinancing. These payments to the owners of Trans-American were as follows:

George Fischer	\$1,180,000
James Brown	620,000
Verdi Adam	<u>200,000</u>
Total Distribution	<u>\$2,000,000</u>

<sup>1</sup> Total 2001 appropriation of \$4,283,295 divided by 686 offenders divided by 365 days per year equals \$17.10 per offender, per day. \$17.10 multiplied by 246 (the number of offenders not actually housed) multiplied by 365 days equals \$1,535,409.

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**TCCY REMAINS PROPERTY OF FBA**

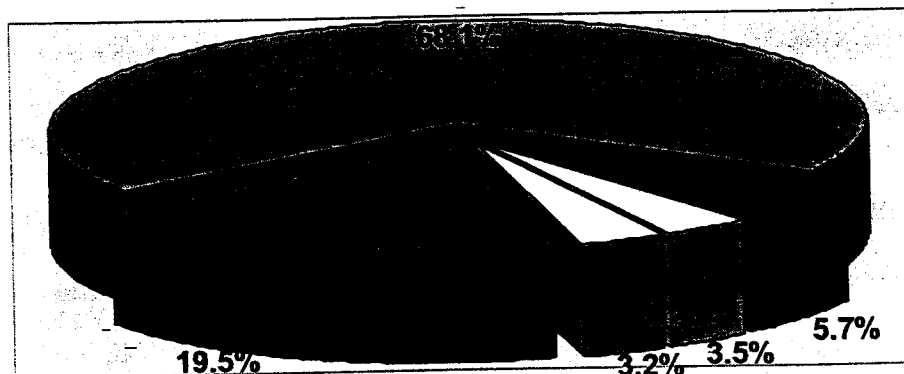
It is noteworthy that at the expiration of this arrangement, the sooner of 25 years or at the time of repayment of the debt, ownership of TCCY will remain with FBA even though DOC will have paid for all of the costs of financing, construction, and operation of TCCY. Furthermore, DOC's consent to Amendment VII provides that DOC may not cancel the agreement so long as the indebtedness related to TCCY remains outstanding.

**CURRENT DISTRIBUTION OF DOC PAYMENTS**

The appropriated amount of DOC's payments during the current (2000-2001) fiscal year is \$4,283,295. DOC currently makes monthly payments of \$356,941.25 to the trustee, Chase Manhattan, who then distributes the money. Based upon the payments made from July 2000 through March 2001, the current year appropriation will be distributed as follows: Certificate Fund, 68.1%; Maintenance Reserve, 5.7%; Property Tax, 3.5%; Insurance Fund, 3.2%; and Distribution to FBA, 19.5%.

As noted above, the distribution to FBA during fiscal year 2000-2001 will be approximately \$834,000. Based on the monthly dividends paid by FBA during this time period, the total amount distributed to FBA's owners will be \$600,000 during this time.

**2000-2001 Trust Distribution**



<input checked="" type="checkbox"/> Certificate Fund	<input checked="" type="checkbox"/> Maintenance Reserve	<input type="checkbox"/> Property Tax
<input type="checkbox"/> Insurance Fund	<input checked="" type="checkbox"/> FBA Distribution	

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**DOC AGREEMENT MAY NOT MEET REQUIREMENTS  
OF COOPERATIVE ENDEAVOR**

The agreement entered into between DOC and the City is considered a cooperative endeavor agreement under Louisiana law. The Attorney General has recognized a threefold test to determine the validity of cooperative endeavor agreements:

1. The expenditure or transfer of public funds or property must be based on a legal obligation or duty.
2. The expenditure must be for a public purpose.
3. The expenditure must create a public benefit proportionate to its cost.

Considering that the agreement requires DOC to pay for at least 246 offenders not actually housed in the facility and that 19.5% of the DOC payments are being distributed to FBA, the public benefit may not be proportionate to the cost incurred by DOC.

**RECOMMENDATION**

We recommend that DOC establish and maintain active participation in the selection of contractors receiving public funds. Such participation should not be neglected where DOC chooses to enter into cooperative endeavor agreements with other public agencies. We further recommend that DOC negotiate such agreements so as to maximize the value received for the expenditure of public funds.

Respectfully submitted,



Daniel G. Kyle, CPA, CFE  
Legislative Auditor

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[rccv]

**DEPARTMENT OF  
PUBLIC SAFETY AND CORRECTIONS**

M. J. "MIKE" FOSTER, JR., GOVERNOR



RICHARD L. STALDER, SECRETARY

May 15, 2001

Mr. Daniel G. Kyle, CPA, CFE  
Legislative Auditor  
P. O. Box 94397  
Baton Rouge, LA 70804

Dear Dr. Kyle:

The following information represents the Department's response to the letter recently submitted by your agency to the Senate Judiciary B Committee.

**1. History**

In 1992 and 1993, the backlog of juvenile offenders pending transfer to state secure facilities approached 400 and was projected to increase to 750 within three years. This was a critical public safety issue. As a result, by early 1994, Orleans Parish was involved in significant litigation in the United States District Court/Eastern District; Ascension Parish was preparing to sue the state to force us to accept their backlog of "pending secure care" juveniles; action had been taken in the Florida Parishes to hold the state in contempt; Jefferson Parish threatened weekly to turn dangerous and violent offenders out of their detention centers; and I was subject to contempt action in over 150 individual cases around the state. Our efforts to secure state funding to capitalize critically needed secure juvenile beds to resolve this problem had not been successful.

In this environment, the cooperative endeavor agreements with the LaSalle Hospital District in Jena, Louisiana and the Town of Tallulah were initiated. They shifted the burden of capitalization from the public sector to the private sector. They offered a total cost to the state inclusive of capitalization that was less than the state's cost to operate its secure facilities exclusive of capitalization. While both projects failed in the long-run to provide safe, stable, and productive operations, and while such ventures will not be repeated in the future, it is important to note the external conditions in which they evolved.

**2. Comments Regarding Section Entitled "Matters for Further Consideration"**

You note that the amendment approved on January 27, 1997, guaranteed TADA payment for more offenders than were actually housed at the facility. We are not paying for offenders who are not housed at the facility. We are paying for buildings that were originally designed to house offenders that are now utilized to provide space for administrative segregation, programming, the Boys Club and medical and mental health

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services. The reduction in capacity and transformation of the use of certain parts of the physical plant were in everyone's best interest. The change in utilization of portions of the physical plant does not imply underutilization. On September 20, 1999, we began to pay \$16.62 per day per bed built, an amount that was, as represented by bond counsel, equivalent to the cost of principal, interest and premium or other requirements of the initial indebtedness. The amount of debt service was converted to a "per diem" per bed built. The state's obligation to pay debt service on a physical plant that is completely occupied is independent of the number of offenders housed there. (September 20, 1999, is the date we assumed permanent operational responsibility and discontinued paying a third party for operational costs.)

You correctly conclude that, at the end of the term of the agreement, the facility will remain the property of FBA even though the state will have paid the costs. To have done otherwise would have made the agreement a capital lease and placed it in the constitutional and general obligation debt limits.

Your concern that the agreement may not meet all of the requirements established by the Attorney General and Louisiana law for a cooperative endeavor agreement is based, as I understand it, on the requirement that the expenditure must create a public benefit proportionate to its cost. I suggest, as mentioned earlier, that the public benefit exceeded the cost from the inception of the agreement at least through September of 1999 as evidenced by the fact that the per diem, which is inclusive of capitalization, is less than the average daily operating cost of a state facility, which is exclusive of capitalization. As I mentioned to your staff during the exit interview, should the Legislature determine that the current payment, (originally designed to cover debt service), provides excessive remuneration to the owners because of reductions in any component of debt service costs resulting from the state's assumption of operations, then the Legislature has the prerogative, through partial non-appropriation, to reduce such payments to cure any perceived disproportionality. That is not an option for the DPS&C because of the "due diligence" clause in the cooperative endeavor agreement. In addition, for reasons outlined above, the agreement does not require the Department to pay for 246 offenders not housed in the facility, (See "DOC Agreement May Not Meet Requirements of Cooperative Endeavor.")

### **3. Analysis of Amendments**

Please note that, neither in the original agreement or in any amendment, does the DPS&C have any responsibility to pay debt service if the agreement is terminated. The only responsibility the DPS&C has for debt service is if the agreement remains in force and the DPS&C utilizes the physical plant and operates the facility.

**Amendment I**-In July of 1994, there were approximately 400 juveniles in local communities backlogged to come into state secure custody. This backlog was projected to increase significantly. That is what precipitated the acceleration and expansion of this project.

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**Amendment II**-The initial scope of Phase I provided short-term boot camp beds only. The state critically needed long-term beds and 50% of Phase I was converted to long-term housing. The additional requirements based upon the change in the mission of the facility prompted the execution of Amendment II.

**Amendments III and IV**-No additional comment.

**Amendment V**-The Department was advised by then State Superintendent of Education, Ray Arveson on June 7, 1995, that the Minimum Foundation Program (MFP) would only provide funds to the Madison Parish School Board for 175 instructional days per year. The DPS&C wanted to provide a twelve month school calendar. This amendment provided funds for the continuation of school for 75 additional instructional days at the MFP rate which converted to a per diem of \$2.88 per offender on an annualized basis.

**Amendments VI, VII, and VIII**-In late 1996, the owners, (through Friedman, Luzzato and Co.), had submitted documentation to Standard and Poors for a rating review prior to re-financing. These amendments were the result of negotiations among counsel for all parties and were intended to enable an investment grade financial transaction. The compromises struck in these amendments were designed to support the goal of shifting the full capitalization of additional secure juvenile beds from the public sector to the private sector.


**Amendment IX**-This amendment was executed at the request of the state to enable litter abatement in northeast Louisiana.

**4. Comments Regarding Section Entitled "Agreement Guarantees Payment for 686 Offenders Though Court Restricted Actual Population to Much Less"**

Relative to the auditor's comments regarding the current \$17.10 per diem for 686 beds, please refer again to Item No. 2 above. As explained to the auditors, in the cooperative endeavor agreement under the section that outlined the state's responsibilities in the event that the state assumed operational control and continued to utilize the physical plant, a dollar amount sufficient on an annual basis to pay debt service, (as represented by FBA bond counsel), was converted to a per diem per bed built, (not per bed occupied.) We use every square foot of the facility. We are not paying for offenders not actually housed at the facility. We are paying for "beds built," not "beds occupied." We programmatically altered how we use certain buildings that used to be part of offender capacity, but are not any longer.

Please advise if you have any questions.

Sincerely,

  
Richard L. Stalder  
Secretary

President  
Standard and Poors

Dear Mr. \_\_\_\_\_:

Louisiana has worked diligently over the past six years since Governor Foster took office to improve its fiscal management and its credit rating. The bond markets have recognized this, and your firm increased our general obligation bond credit rating to "A" at the beginning of the governor's second term in 2000. [Adjust rating for each of the 3 rating agencies] Both the governor and the legislature believe very strongly that Louisiana has an obligation to pay its debts. The governor and the legislature also have an obligation to manage the state's fiscal affairs prudently and terminate contracts when they are breached by the other party to the contract.

You are aware that the state legislature has considered terminating the cooperative endeavor agreement ("Agreement") for use of the juvenile justice facility in Tallulah, Louisiana. As you are also aware, the payments by the state are used by the owner of the facility, a private, for-profit company, to pay off the privately-issued certificates which the owner caused to be issued to refinance the debt it had previously incurred for the construction of the facility. This letter will explain why the state has considered terminating the Agreement and why we believe it would be inappropriate to lower the state's bond rating as a result of the state's terminating the Agreement.

The state does not intend to act precipitously in this matter. As soon as the financial markets expressed concern over the termination, the legislative leadership, with the support of the administration, amended the appropriations bill to maintain funding for the Tallulah payments. It is our intention to maintain that funding unless and until we are able to resolve all outstanding issues with all parties.

In considering terminating the Agreement, the state is not seeking to renege on a commitment. It is not trying to stop the payments merely because it has a technical right to do so under the Agreement. Rather, the state is considering termination because the private operator has defaulted on its obligations and has breached its agreements, as will be shown below.

In 1994, the Louisiana Department of Public Safety and Corrections ("the Department") entered into the Agreement with the Town of Tallulah for the construction and operation of a 686 bed secure facility for juveniles. As was contemplated by the Agreement, in April of 1995 the Town of Tallulah signed a contract with Trans-American Development Associates, Inc. ("Trans-American"), a closely-held corporation owned by three individuals, to construct and operate the facility. This agreement essentially transferred all of the Town's obligations under the Agreement to Trans-American. Trans-American, in turn, contracted at various times with FBA, L.L.C. ("FBA") so that FBA became both the owner and the operator of the facility. FBA is a closely-held limited liability corporation owned by the same three people, in the same proportions, who own Trans-American. In this letter, references to FBA include Trans-American unless otherwise noted.

In addition to constructing the physical plant of the facility, FBA was also to operate the facility or to subcontract its operation to other private companies in the business of operating such facilities. Before juveniles were housed in the facility, a consent decree was entered by the Department and FBA in federal district court governing conditions at the facility. The payments made by the state under the Agreement went not only toward use of the real property but also toward paying for all of the operating costs of the facility. The facility opened, subject to the consent decree, in November of 1994.

There were two phases to the construction of the facility. Phase 1 involved secure but non-cell block beds. Phase 2 involved the construction of cell blocks for housing the most dangerous and violent offenders. Construction of both Phase 1 and Phase 2 was paid for with private bank financing obtained by FBA.

In 1998, the Department signed amendments to the original Agreement to facilitate FBA's access to privately-raised capital. The only documents ever signed by the state relating to the construction, financing, or operation of this facility were the original Agreement, the various amendments to it, and one consent and acknowledgment of the assignment of the Town of Tallulah's rights and obligations to FBA, which will be discussed later.

It was not until late 1996, well after the facility had been the subject of enormous criticism and adverse publicity, that FBA decided to refinance the private bank debt it had incurred in constructing the facility. To this end,

FBA arranged for a private placement of Taxable Beneficial Interest Certificates, issued by First Tennessee Bank National Association as trustee bank. FBA used the cash flow derived from the Agreement to secure these certificates. The certificates were backed by a Municipal Bond Insurance Policy issued by Ambac Assurance Corporation.

The state agreed to make a few amendments to the Amendment to clarify some provisions in order to facilitate the private issuance of these certificates. Other than by making these amendments, which did not increase the state's obligations in any substantive way, and by providing information to interested parties, the state had no involvement whatsoever in the issuance of these certificates. The state did not in any way guarantee payment to either the purchasers, the issuer, or the insurer of the certificates. The only connection the state had with this financing was through the Agreement it signed with the Town of Tallulah. The Agreement itself makes no mention of how Tallulah or FBA would obtain financing. Because the Agreement had a non-appropriation clause and did not involve state-issued bonds or state guarantees for the private financing, the transaction was not required to be and was not in fact reviewed by the state Bond Commission or any other public body.

In May 1998, after it signed the final amendment to the Agreement, the Department also signed a "consent and acknowledgment" which documented the Department's understanding that the City of Tallulah had assigned all of its rights and obligations under the Agreement to FBA. The Department also acknowledged that FBA was seeking financing through privately-placed taxable revenue beneficial interest certificates, and agreed that it would write its payment checks to the trustee bank. The acknowledgment specifically provides that "any assignment, sale or transfer of any such Certificates does not require the Department's approval." In other words, the Department had no control whatsoever over the issuance of the Certificates.

Further, under the Agreement the state will never acquire any equity interest in the facility or in the land on which it was built. The Agreement provided only that the state was paying to have the private parties properly and safely operate a detention facility at the Tallulah location.

Finally, the Agreement specifically stated that the agreement “is only executory to the extent that funds are so appropriated... In the event funds [are not appropriated], such inability shall not constitute a default under this agreement.” In sum, the credit of the state never supported this privately-issued financing for FBA, a private, for-profit corporation. The biggest risk was not non-appropriation of payments by the state, but rather the risk of default on the part of FBA to operate the facility in accordance with the terms of the Agreement and FBA’s contracts with the Town of Tallulah. Despite the clearly stated right of the legislature to cease payments at any time for any or for no reason, the State would nevertheless continue the funding if FBA had performed its obligations pursuant to the Agreement and FBA’s contracts with the Town. Unfortunately, however, FBA has not performed its obligations. Therefore, it would be fiscally irresponsible if the state did not consider terminating the Agreement because of this breach of contract.

FBA breached the Agreement repeatedly and significantly during the life of the agreement. At the time the Tallulah facility opened, some of the operations of the Department were being overseen by the United States District Court for the Middle District of Louisiana, the Honorable Frank Polozola, Judge. Because of this, no juveniles were housed at Tallulah until both the Department and FBA entered into a stipulation and consent decree governing conditions to be maintained at the facility. This consent decree was entered on November 15, 1994, and the facility opened at that time.

On December 22, 1994, Judge Polozola declared a state of emergency at the facility, following what he characterized as a “riot”. FBA then terminated its contract with the company with which it originally subcontracted the operation of the facility on December 29, 1994. On January 1, 1995, the Department sent its own officers into the facility to oversee operations there. This was the first of several occasions over the next several years in which the Department was forced to assume direct control of the facility because of the failure of the operators to run it in a safe, responsible manner. The private owners replaced the warden of the facility several times, to the extent that it had at least 6 different wardens from the time it opened until operations were permanently assumed by the State five years later, in 1999.

In April 1996 the U.S. Department of Justice (“USDOJ”) began to investigate Louisiana’s secure juvenile facilities, focusing heavily on

Tallulah, which was being operated by FBA or its subcontractors. Experts retained by USDOJ toured the facility in the summer of 1996. In June 1997, USDOJ notified the State that conditions at the Tallulah facility justified intervention by USDOJ under the Civil Rights of Institutionalized Persons Act.

It would be impossible to detail all the many transgressions and serious deficiencies found by USDOJ during the private operator's tenure. The record of those deficiencies is available and will be provided for any proof required. At least ten USDOJ experts toured the facility from 1994 through 1999, generating approximately 20 to 25 detailed reports of serious deficiencies at the facility. Two experts appointed by Judge Polozola also conducted numerous inspections and generated at least a dozen highly critical reports of the facility as operated by FBA and its subcontractors. Generally, the major deficiencies can be grouped in four broad areas: medical, mental health, education, and juvenile justice/protection from harm.

In January 1998, Judge Polozola terminated future intake of juveniles at Tallulah. That intake resumed in September 1998 when the parties entered into an "interim agreement" that placed tighter controls on its operations, seeking to rein in the abuses of the private operators. The interim agreement also capped the population at 536 juveniles, although the Agreement provided for FBA to provide the capacity to hold 686 juveniles.

In July 1998, the Juvenile Justice Project of Louisiana, a non-profit legal advocacy organization based in New Orleans, filed a lawsuit on behalf of juveniles at Tallulah against the state in the U.S. District Court for the Western District of Louisiana. In November 1998, the U.S. Department of Justice filed a suit against the state over the conditions at Tallulah in the U.S. District Court for the Middle District of Louisiana. Trial on the lawsuits was averted when FBA replaced the operator of the facility and contracted with Correctional Services Corp. ("CSC"), a corporation which operates a number of juvenile incarceration facilities around the country, to assume operation of the facility.

On September 14, 1999, about 20 security officers employed by CSC abandoned their posts at the facility. The Department conducted an emergency investigation of the facility. On September 21, 1999, CSC, the last private company to operate the facility under subcontract to FBA,

abruptly and unilaterally withdrew from the facility, leaving operation of the facility to the Department, which has operated it with its own employees ever since. Subsequent to its abandoning of the facility, CSC has, incredibly, instituted litigation against the state relating to these events.

Under the Agreement, as most recently amended in January 1997, it is the responsibility of the City of Tallulah (Tallulah grew from a "town" to a "city" between the first cooperative endeavor and the final amendments), which responsibility it has assigned by contract to FBA, to operate and maintain a juvenile detention facility, "in accordance first with the appropriate standards adopted by the State and second pursuant to the standards established by the American Correctional Association." (Section 7.A.) The Agreement clearly and properly provides a mechanism for the state to terminate the agreement if the City, or its contractors, fails to fulfill this obligation. Ultimately, the Department has the right, if it is forced to assume the operational duties of the facility because of repeated and uncorrected failure to operate and maintain the facility properly, "subject to Section 6 hereof" to "terminate this Agreement in any and all subsequent fiscal years," provided that so long as the Department continues to use the physical plant of the facility, it will pay, if funds are appropriated, a reduced per diem to lease the physical plant. (Section 8-I.D)

Section 6 of the Agreement provides for the expiration of the Agreement if the legislature fails to appropriate funds for the Agreement. It further provides for the Department to exercise due diligence in seeking the appropriation, including making provisions for the funds in its budget submissions and using "its bona fide best efforts" to have such portion of the budget approved. Section 6 also specifically provides that, if the Department is unable to make payments owed under the Agreement because such funds were not appropriated, then "such inability shall not constitute a default under this Agreement."

Had FBA performed its obligations and operated the facility in the manner to which it had agreed, then the situation we now face would not have arisen. The state has only considered termination of the agreement because of FBA's complete failure to run a safe and effective juvenile detention facility. Clearly, this failure has had significant deleterious effects on the state's ability to provide effective correctional services to juveniles.

The state made no guarantees of unconditional payment to the City of Tallulah, FBA, Ambac, or any other party. Not only did the state specifically reserve the right for the legislature to terminate the Agreement at any time, it specifically reserved the right for the Department to terminate the Agreement for breach of contract. Indeed, no contract is ever expected to continue after breach.

There was indeed credit risk undertaken by the private parties associated with this transaction, and that risk was clearly set forth in the documentation upon which the credit was established, which specifically highlighted the risk of default by FBA discussed above. These credit instruments were privately issued, without state participation. Your agency and others rated the risk of these privately-issued certificates based solely on “the bond insurance policy that Ambac Assurance Corporation (Ambac) is providing.” [Fitch language. Moody’s language is “based upon an insurance policy provided by Ambac Assurance Corporation. Still need S&P language] Nowhere in the credit rating notifications on these certificates is there any reference to a guarantee by the state to pay these obligations. There was no such guarantee. Those rating letters do not suggest in any way that your agency’s rating decision was based in any way on the state’s own general obligation bond credit rating, and properly so, because the state had no participation in either the issuance or the insurance of the instruments.

As I noted at the beginning, the state places a high priority on maintaining its good credit. We believe that, were the state to terminate the Agreement based on the breach by the private parties, there is no reason for the state’s general obligation bond credit rating to be affected. Indeed, failure to terminate a contract where the party contracting with the state has breached the contract would be irresponsible. If anything, your agency should reconsider the state’s credit rating if it were to *fail* to terminate such a contract.

Recognizing that these are complicated issues, we would like to clear the air by communicating directly with your agency about these matters, and avoid third-party intermediaries. To that end, I would appreciate hearing from you, in writing, addressing your firm’s point of view and the likely reaction your firm would have if the state were to terminate the Agreement for the reasons outlined above. Further, because the state desires to reach a negotiated resolution to this matter, I would like to arrange a meeting between your

firm and Mark Drennen, our Commissioner of Administration, and other state officials to discuss this matter in more detail.

If you have any questions, please call me at 225-342-0955.

Sincerely,

Bernard E. Boudreaux, Jr.  
Executive Counsel